IN THE
Supreme Court of the United States
OCTOBER TERM, 1975

No. 75-1305

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

REPLY OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK TO BRIEF IN OPPOSITION OF THE FEDERAL POWER COMMISSION

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The petition for a writ of certiorari filed in this case by the Public Service Commission of the State of New York ("New York"), like the petition filed in Case No. 75-1308 by The Associated Gas Distributors ("AGD"), is limited to one important and novel feature of the Federal Power Commission's opinion establishing a nationwide rate for new gas production.[1] This is the Commission's automatic application of the higher rate it established for new gas to the oldest and cheapest vintages of flowing gas, at a multibillion dollar cost to gas consum-

[1] The issue has also been raised in the petition filed by the American Public Gas Association (APGA) in Case No. 75-1304.

ers, whenever the producer and pipeline enter into a new sales contract at the expiration of the initial contract.

The Commission's Brief in Opposition[2] does not purport to deny the great and continuing significance of the issue. Moreover, since the Commission's action of which we complain constitutes a marked departure from its actions in the previous area rate proceedings considered by this Court, the Commission cannot and does not suggest that the questions raised by New York and AGD are disposed of by the Court's decision in the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), or *Mobil Oil Corporation* v. *Federal Power Commission*, 417 U.S. 283 (1974). Instead, without any serious effort to discuss the specific contentions made by New York as to the deficiencies in the Commission's and Court of Appeals' justifications for this multibillion dollar non-cost increase in the rates producers can charge for flowing gas without assurances that any portion of this huge fund would be devoted to further efforts for the interstate gas market, the Commission confines itself to citing the court's recital of its own inadequate findings and conclusions.

The Court below believed that in view of the still "experimental" nature of producer pricing, a "kid glove treatment" of otherwise inadequate Commission findings was required (Pet. App. A-19). Under this standard of review it believed that the huge non-cost allowance could be justified in view of the Commission's general finding that an adequate gas supply effort would require a "massive commitment of new funds" and the court's erroneous reading of the Commission opinions as find-

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[2] Pursuant to leave granted by this Court, the Commission's opposition to New York's petition, and five others seeking review of the same Court of Appeals opinion, was filed on May 27, 1976 under the style of "The California Company, et al. v. Federal Power Commission".

ing that "internally generated funds are a *necessary* source of such funds" (Pet. App. A-29, emphasis added),[3] coupled with the Commission's expressed hope "that by requiring an old contract to be renegotiated before the new rate is recoverable, the pipeline *might* be able to negotiate for additional acreage dedication to interstate commerce, or exploration and development activity on previously dedicated acreage, or other concessions for the price increase" (*ibid.*). The court of appeals also apparently believed that the Commission's action in authorizing the multibillion dollar allowance was excusable since it was "tentative" and subject to reconsideration in the biennial review proceeding the Commission had initiated in the light of its evaluation therein of whether the additional revenues generated had in fact led to greater gas search efforts. (Pet. App. A-30). The Commission Brief in Opposition significantly does not rely on this part of the opinion below. This is because, as New York stated in its petition, the only reconsideration of this matter the Commission apparently intends to entertain in the biennial review proceeding is as to whether the still higher new gas rate established therein should be made available to the oldest and cheapest vintages of flowing gas.

If this were a situation such as that presented in the *Mobil* case *supra*, where potentially large non-cost increases in flowing gas revenues were authorized only to

[3] While the Commission found that much of the capital for producer production efforts had typically come from gas production revenues (Pet. App. D-16, D-55-56), it did *not* find that internally generated gas revenues were the "necessary" source of funds for an optimum gas search effort. It could not do so in view of record data as to the availability of other funds if the opportunity price is right (see, *e.g.*, Pet. App. C-267-270) and industry experience in virgin areas such as the North Slope of Alaska and the North Sea. See *Public Service Commission of the State of New York* v. *Federal Power Commission*, 487 F.2d 1043, 1073 (D.C. Cir., 1973), remanded *sub nom.*, 417 U.S. 964 (1974).

the extent that additional gas was in fact dedicated to the interstate market, it might be less important for the Commission to have some factual basis for believing that at least a substantial portion of its largesse would be devoted to additional efforts to secure gas for the interstate market.[4] But even in such circumstances and even if the Commission's determination was in fact a tentative one subject to prospective recission in the biennial review proceeding, it would not have justified the Commission's complete refusal to address itself in any of its opinions to the arguments against its proposal made by New York, AGD, and the American Public Gas Association, or to make any effort to evaluate the results of a similar, if more limited, experimental program it had initiated two years earlier. The court below recognized its responsibility was to ensure that the "Commission has exercised its discretion after considering all pertinent options" (Pet. App. A-29). The simple fact is that the Commission made no effort to do so before granting the producers a multibillion non-cost allowance for which no *quid pro quo* was required.

Even if it is assumed that the establishment of an appropriate new gas price approximately double that previously in existence would be inadequate to induce the necessary additional effort by the producers in the absence of an increased cash flow from existing gas sales, (but see n.3, *supra*), the method chosen by the Commission for achieving this objective was unsupportable. The Commission itself recognized that it "cannot set a price for new gas without also considering the cash flow consequences of its pricing policies for old gas" (Pet. App.

[4] Thus the contingent escalations of flowing gas rates approved by this Court in the *Mobil* case *supra*, never became effective since the producers did *not* dedicate the requisite additional volumes of gas to the interstate market. This is also true with respect to the contingent escalation provisions included in several other Commission area rate orders.

C-97). However, it made no effort to consider whether any conceivable inadequacy of the cash flow available under the flowing gas rates of its pre-existing area rate orders would be eliminated by higher national rates for flowing gas to be established in the separate proceeding it had established for that purpose in Docket No. 478.[5] Equally important, the Commission completely ignored the arguments of New York and AGD that automatically granting producers the new gas price when they are able to persuade the pipeline to enter into a new contract not only would not lead to substantial new investment on behalf of the interstate market but would be likely to detract from the efficacy of the Commission's existing programs to use price as a regulatory tool to induce new efforts in behalf of the interstate market.

If, contrary to New York's view, it could be demonstrated that an optimum increase in production efforts on behalf of the interstate market required a discrete increase in gas revenues over the ensuing six years of the magnitude indicated by the Commission's action in permitting producers to charge the new gas rate for their oldest and cheapest gas, (and this revenue increase would not in any event result from the increased rates to be authorized for flowing gas), the first questions one would expect the Commission to consider were why such increases should be assigned to the oldest and most rapidly depleting vintages of flowing gas rather than as a

[5] In Opinion No. 749 in Docket No. 478, issued on December 31, 1975, the Commission fixed the nationwide rate for old gas at a level of 23.5 cents per Mcf, escalating to 29.5 cents per Mcf as of July 1, 1976. The great bulk of rates for gas classifiable as old gas was sold under rates established by the pre-existing area rate orders at levels considerably below either figure, ranging down to 12.5 cents for gas produced in the Panhandle and Hugoton fields in Kansas. (In those few cases where the old gas area price was above the nationwide level fixed by the Commission, the higher area rate prevails.) On February 27 1976 the Commission granted rehearing of Opinion No. 749 for the purpose of further consideration of a number of petitions for rehearing.

per Mcf allowance for all old gas,[6] and why such allowance, regardless of the vintage of flowing gas to which it is applied, should not, as a minimum, be tied to a pledge by the recipient producer to expend the amount received in additional gas supply efforts for the interstate market. No such consideration appears to have been given by the Commission prior to adoption of its program here. It simply is not good enough for the Commission to suggest that its insistence that the new gas price will be available only when producer and pipeline enter into a replacement contract, *might* give some of the pipelines sufficient leverage to require some *quid pro quo* for the increased revenues. In a period of acute gas shortage the far more likely possibility is that if the pipelines with expiring sales contracts wish to secure any of the offshore gas the producers might then or in the future have for sale (and are in any event obligated to sell to the interstate market) they will have to agree to sign new contracts which would authorize the producer to secure the new gas levels for their flowing gas.

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[6] Thus the Commission noted (Pet. App. C-96, n. 118) that in some area rate orders it had provided an additional non-cost allowance of several cents per Mcf to provide what it believed was an adequate cash flow for future reinvestment. A two cent per Mcf surcharge on the approximately 22.5 Tcf of flowing gas produced as of the end of 1972 (Pet. App. C-126), assuming depletion at a level of 10% per year, would produce additional revenues of about $2,075,964,000 over the same 8 year period Commissioner Smith utilized in estimating the cost of the Commission's allowance in issue here. But unlike the Commission's plan, which would start out in 1974 with a yield of about $127.2 million and build up to an annual amount of $560.7 million in 1981, an across the board surcharge would produce the largest sum at the beginning of the eight year period when it assertedly is most needed. Equally important, any across the board surcharge, even if it was tied to producer reinvestment of the additional revenues in gas production efforts on behalf of the interstate market, would retain a substantial differential between new and old gas rates, and thus continue to provide an incentive for producers to upgrade production on their existing wells in return for further price concessions.

The Commission appears to suggest at page 15 of its Opposition that in view of the gas supply shortage it can, in effect, establish whatever higher producer rates it believes appropriate and gas consumers then have the burden of demonstrating that its conclusion is utterly devoid of rational content. Recognizing that a reviewing court cannot substitute its or our judgment for that of the Commission where it fixes upon a course of conduct after considering all available evidence and the arguments pro and con, nothing this court has previously stated can be interpreted as providing the Commission with the blank check which it seeks here.

The Commission neither proposed to make its national new gas rate applicable to flowing gas sold under renewable contracts in its various notices in the rulemaking proceeding or sought to secure a record on this question (though it requested comments on many other facets of the new gas rate.). It has ignored all arguments against its action. It has refused to examine the available record of its earlier similar experiment to test the validity of our claims that the expanded program, far from producing any substantial increase in interstate gas supply to match its huge cost, would be likely to lessen the existing incentive of producers to up-grade their flowing gas operations through well reconditioning or other undertakings in return for a rate increase. And it gave no apparent consideration to possible alternatives which would be less costly or more effective. Under these circumstances it is imperative that this Court grant the petitions for certiorari which seek to review the Commission's action which permits producers to collect billions of additional dollars in revenues, unrelated to their costs, but does not require them to devote any portion thereof to efforts to increase the gas supply for the consumers required to pay the tab.

CONCLUSION

For the reasons set forth herein and in the initial petition filed by New York, the question of the validity of the Commission's action authorizing the nationwide new gas to be automatically available to old low cost gas sold under replacement contracts is both novel and of great importance to the proper exercise of the Commission's responsibilities under the Natural Gas Act. Certiorari accordingly should be granted to review this facet of the court of appeals opinion below.

Respectfully submitted,

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